Letter to Carole Washburn:

April 20, 2001

VIA FAX, ELECTRONIC MAIL, FIRST CLASS MAIL (WUTC ONLY)

Re: Puget Sound Energy Time of Day (TOD) Rates Proposal
Docket UE -010409

Dear Ms. Washburn:

Public Counsel continues to have concerns with PSE's second revised time of day rates proposal filed this April 17. While the latest proposal does avoid some of the problems of the earlier plan, we believe it still is a flawed approach to the region's current energy supply situation, from a policy perspective. Public Counsel may file additional comments on the merits of the proposal prior to the April 25 open meeting. We continue to support approval of the Conservation Credit proposal.

The purpose of this letter, however, is to focus on a threshold question which, in our view, must be addressed in deciding whether to approve the TOD proposal – namely, whether the proposal is permitted under the terms of the order approving the Puget Power & Light/Washington Natural Gas merger, in particular the Rate Plan and the service quality index. Public Counsel's conclusion is that the TOD proposal, unless made voluntary, is not permitted under the Rate Plan, even in its modified form.

1. <u>The Puget Power & Light/Washington Natural Gas Merger</u>

In February 1997, the WUTC approved the merger of Puget Sound Power & Light with Washington Natural Gas, reviewing and adopting as its own the term and conditions set out in a Stipulation between the Commission Staff, Public Counsel, and the merging companies. *In the Matter of the Application of PUGET SOUND POWER & LIGHT COMPANY and WASHINGTON NATURAL GAS for an Order Authorizing Merger*, Docket Nos. UE-951270, UE 960195, Fourteenth Supplemental Order Accepting Stipulation; Approving Merger ("Merger Order")(The Stipulation is Appendix A to order)

The Commission conducted extensive proceedings on the merger. Fifteen days of hearings for preliminary and evidentiary matters were held in several sessions from August to November 1996. Two public comment hearings were held. Ultimately, a settlement was entered into by the merger applicants, Public Counsel, and the Commission Staff. The Merger Order held that "upon review of the proposed settlement and the record in this matter, the Commission is satisfied that the merger, *provided that the terms of the Stipulation are adopted*, is in the public interest." Merger Order at 43. (emphasis added).

2. The Merger Rate Plan

A central term of the Stipulation was the Rate Plan. Merger Order, Appendix A, p. 4. The Rate Plan specifies that for a period of five years, through December 31, 2001, the "changes in PSE's electric and natural gas rates *shall only be* as provided in Section III.A [of the Stipulation] herein." Stipulation, Section III.A.1, p. 4 . (emphasis added). The only change permitted under the plan for general rates during the year 2001 is an increase of either one percent or one and one half percent on January 1, 2001. Stipulation III.A.3.b. Those increases have been implemented.

There can be no dispute that PSE TOD proposal will result in an increase in electric rates outside of the increases allowed by the Rate Plan. Due to increased rates for electricity used during the morning and evening peak periods, a significant number of customers, using the same power at the same times of day as previously, will see larger bills than they received before TOD rates.

In the context of the merger, however, the Rate Plan is more than a simple cap on retail rates. Instead it represents a carefully struck balance between a variety of important customer and company interests. The Commission placed heavy emphasis throughout the order on the balance which the Rate Plan reflected, stating:

> [T]he Rate Plan reflects the implicit balance struck by the stipulating parties between *five years of "rate certainty"* for customers, and *five years of opportunity* for the company to manage its resources and cost pressures. Merger Order at 21. (emphasis added).

The Commission carefully examined "whether the Plan, as offered in the Stipulation and supported by the parties, strikes a fair and reasonable balance between the estimated merger savings, future rates for customers, and investor needs." Merger Order at 25. It concluded that the Rate Plan was in the public interest and that "[t]he Stipulation establishes suitable rate protections and strikes an appropriate balance between affected interests." Merger Order at 26. This determination is integral to the Commission's decision to approve the merger itself as being in the public interest. Findings of Fact 9, 11, 14. Merger Order at 45-46.

Clearly, the Rate Plan incorporates and furthers a number of important policy goals: rate certainty, rate stability, equitable sharing of merger benefits, investor interest and the opportunity for Puget to manage cost pressures. For this reason, an alteration of the Rate Plan not only costs customers more, it disturbs the entire balance of interests struck by the Merger Order. It is this balance upon which Public Counsel, and indeed all the parties, relied in agreeing to support approval of the merger. These terms should not lightly be changed.

3. The "Carve-Outs."

The Rate Plan allowed Puget to pursue, or continue pursuing certain regulatory initiatives. We understand PSE to acknowledge that the TOD proposal increases rates beyond what is permitted in the Rate Plan, but to argue that the "regulatory initiatives" (the "carve outs") provisions of the Rate Plan allow this kind of proposal. The "carve out" relied on is that which allows PSE to "propose cost of electric service changes and redesign of electric rates as necessary to accommodate the changing market and restructuring in the electric industry."

PSE misreads the meaning and intent of this provision. In a nutshell, the "restructuring carve out" is clearly intended to allow changes in rate design only if necessary to deal with industry restructuring, in particular a change necessitating unbundled rates. Fortunately, the Commission took pains to clarify in its Merger Order the scope of this carve out, perhaps anticipating debates of the type now raised.

Most instructive is the Commission's discussion at page 26:

> Another point of clarification addresses the relationship between the rates that result form the Rate Plan and customer rates that might occur *should the future see unbundled rates.* The Stipulation acknowledges and provides the flexibility for rate design changes to respond to industry restructuring. (emphasis added).

The Commission went even further in its effort to provide clear guidance in interpreting the carve-out.

> To avoid any future ambiguity, the Commission wants to state clearly that the rate levels established in the Rate Plan are caps on rates for fully bundled utility service. If unbundling occurs, it may not be possible, or appropriate, to apply these caps to any specific unbundled service or any combination of unbundled and competitive services. Merger Order at 26 (emphasis in original).

In summing up, the Commission again referred to "rate design changes to unbundle services, or otherwise address industry restructuring and accommodate competition." Merger Order at 26.

The intent of the carve-out is even more clear from a review of the transcript of the merger settlement hearing on December 18, 1996. For example, Commissioner Hemstad inquired of the panel regarding the restructuring provision:

> COMMISSIONER HEMSTAD: The other side of that or the provision about restructuring, assume that sometime in the reasonably near future during this five-year period Congress will have passed legislation requiring structural disaggregation and open competitive markets and with it unbundling. In that kind of context, what would be the likely response of the company to come before the Commission in effect saying the deal is off?

> MR. ELGIN: Well, I think in that scenario the company would come before you and it's just a matter of how quickly all that happens, and if that were the case I think the company would be in front of you and we would have a full evaluation of the cost of service and I would hope as well that at that point in time the company would have been able to realign its costs, and when we went to a functional dissagregation this electric operation would look a lot like the gas business that you regulate right now, and you would see different rates and different kinds of services and new ways of doing cost studies…. (Docket UE 960195, Vol. 16, Tr. 2528, line 19- Tr. 2529, line 14).
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> COMMISSIONER GILLIS: So in an unbundled retail environment then it's possible within the terms of the stipulation that a particular class of customer could see an increase of prices within the period of time we're talking about. Within I guess the rebundling of those unbundled pieces it would be higher than was agreed to in the stipulation?
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> MR. ELGIN: That could be but, again, the Commission will determine what those are, and I can assure you that when those filings come before you and you look at those cost studies as contentious, as allocated cost studies were in a bundled environment[.] (Id., Tr. 2533, ll. 7-22.)(See also question of Chairman Nelson re "disaggregation" or PSE operations under federal law as captured by carve outs, Tr. 2518, ll. 2-7).

Unbundling of rates has not occurred for PSE's customers, nor for Washington's utilities generally, either as a result of industry restructuring or otherwise. Industry restructuring as contemplated in the settlement and stipulation in Washington has not occurred. Investor-owned utilities like PSE are still vertically integrated and pervasively regulated under Title 80. Wholesale markets were already in existence at the time of the merger, as was market-based pricing for large industrial customers under Schedule 48. It is not enough for PSE to argue that circumstances have changed since the merger order. The Merger Order itself contemplated that circumstances would change, and in general, balanced the risks and benefits of the change. The Commission noted, for example, that the settlement panel testified that "establishing some certainty with respect to rates during a period of transition to retail competition will assist PSE in managing its costs during the transition period." Merger Order at 14.

Finally, both the language of the carve-out itself and of the Commission's order require that the proposed changes be *necessary* to accommodate industry restructuring. The carve-out does not apply to any change of any kind that might seem like a good idea. It must be a change required by the specified new conditions. Thus in its initial discussion of the "very general" nature of the carve outs as a whole, the Commission pointed out that "in particular, the Stipulation provides for rate design changes to occur *as made necessary* by structural changes in the electricity industry." Merger Order at 23. (emphasis supplied).

PSE has at best made the case that TOD rates are worth considering at some point, after adequate review, to be implemented after the Rate Plan ends. It has made no case that industry restructuring has occurred, that unbundling is under way, or that any such changes make TOD

rates necessary. It is significant that PSE has not made any mention in its tariff filing of the Rate Plan, or of "restructuring carve-out" provision, nor did it make any effort to establish that the TOD proposal is a "regulatory initiative" allowed under the Rate Plan "carve-out." The "carve-out" argument has only been raised after the filing in response to objections raised by Public Counsel and others.

PSE can remedy the conflict with the Rate Plan in two ways. If it wishes the program to go in to effect prior to January 2, 2002, it should make the program voluntary. Public Counsel would not object to the current proposal if it were voluntary. Alternatively, PSE can request an effective date for a mandatory program which begins after January 1, 2002. In that event, Public Counsel would have no objection on Rate Plan grounds, although it would still reserve the right to address program design issues, preferably during a suspension period.

4. The Service Quality Index

The Merger Order adopted a Service Quality Index and customer service guarantee. Merger Order at 32; Appendix A, Stipulation, p. 11. The SQI program permits PSE to file for mitigation of any penalties due under the program. Appendix A, Stipulation, p. 13. PSE's initial advice letter requests "that any potential impacts of implementing this program on service quality indices be disregarded by the Commission." Advice No. 2001-10, March 27, 2001, p. 2. It is unclear whether PSE continues to advocate this approach. If so, Public Counsel opposes granting this request. The Merger Order does not provide for a waiver of the SQI. The appropriate course for PSE is to request mitigation of any penalties that may be incurred, should the TOD program be allowed to take effect.

5. Recommendations

Public Counsel continues to recommend that the Commission suspend PSE's TOD proposal, as currently filed. After suspension, the Commission could take briefs, and if it chose receive evidence by affidavit or hearing, on the issue of permissibility under the Rate Plan. Presumably, a preliminary phase of suspension to determine consistency with the Merger Order could be resolved fairly quickly. If it is held to violate the Merger Order, PSE could withdraw the proposal, or revise it to extend the effective date or make it voluntary during 2001. Alternatively, if PSE or the Commission on its own motion wished to consider alteration or amendment of the Merger Order to allow TOD rates, a proceeding could be initiated under RCW 80.04.210. In general, such a proceeding would need to incorporate the due process requirements of notice and hearing for complaint cases, pursuant to RCW 80.04.110 and 80.04.120. Public Counsel believes that given the careful balancing of interests reflected in the Merger Order, that a strong justification must be made to alter its provisions.

As noted above, however, Public Counsel would waive its objections to PSE's implementation of its current revised proposal on a voluntary basis, since a voluntary pilot program would provide customers with a choice as to changing their rates.

Finally, Public Counsel continues to recommend that the Commission approve PSE's Conservation Credit proposal, with the condition that it be reviewed as to the level of the credit at the end of the summer.

Thank you for your consideration of these comments.

Sincerely,

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